

GAO

Report to the Chairman, Subcommittee
on Military Readiness, Committee on
Armed Services, House of
Representatives

August 2000

DOD COMPETITIVE SOURCING

Savings Are Occurring,
but Actions Are
Needed to Improve
Accuracy of Savings
Estimates



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Abbreviations

DOD	Department of Defense
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense



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United States General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-285302

August 8, 2000

The Honorable Herbert H. Bateman
Chairman, Subcommittee on Military Readiness
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

Since late 1995, the Department of Defense (DOD) has encouraged the services and the Defense agencies to conduct cost comparison studies as provided for in the Office of Management and Budget's Circular A-76. Under the A-76 process, otherwise known as competitive sourcing, Defense components study commercial activities being performed by government personnel to determine whether it would be more cost-effective to maintain the activities in-house or to contract with the private sector for their performance. Between fiscal year 1997 and 2005, DOD plans to study activities involving about 203,000 positions under competitive sourcing; studies of activities involving about 9,000 positions had been completed as of September 30, 1999.¹

¹This figure does not include approximately 2,500 positions directly converted to or from contractor performance without a cost comparison study.

By studying activities involving about 203,000 positions, DOD expects to achieve about \$9.2 billion in savings during the fiscal year 1997-2005 period and \$2.8 billion in annual recurring savings after fiscal year 2005, which it plans to use to fund other priority needs such as modernization.² We have reported that costs for completing A-76 studies and implementing the results can reduce savings expected in the short term. After the study and implementation are completed, changes to operating requirements can occur that can affect the extent to which savings are realized and, in some cases, make tracking cost and savings estimates increasingly less practical over time. We have also questioned the reliability of historical data DOD uses to record costs and savings,³ however, the data are currently being used to reduce budgets in anticipation of expected savings from current A-76 studies.

On the basis of your request, we (1) assessed the extent to which actual savings have been achieved or can be expected as a result of competitions and (2) identified DOD's efforts to improve processes for identifying and tracking changes to cost and savings estimates. We judgmentally selected nine A-76 studies that had been completed by the Army, the Navy, the Air Force, and the Defense agencies between October 1995 and March 1998 for a thorough analysis of projected savings. We judgmentally selected these studies to provide a mix of A-76 studies won by the public and private sectors as well as studies completed across the various Defense components. While our sample is insufficient to identify trends, it gives some indication of the challenges DOD faces in accurately determining savings realized from its A-76 studies. Appendix I provides summary information on each case study. Appendix II provides additional information regarding our scope and methodology.

Results in Brief

Available data indicated that DOD realized savings from seven of the nine A-76 cases we reviewed, although less than the \$290 million savings the Defense components initially projected. Neither we nor DOD could precisely quantify the extent of savings from these nine cases. Savings

²Activities involving an additional 42,000 positions are expected to be reviewed under a business process reengineering initiative, referred to as strategic sourcing, which is expected to help DOD achieve a total of \$11.7 billion in savings for these combined efforts by 2005 and increase the amount of recurring savings to \$3.5 billion annually thereafter.

³*DOD Competitive Sourcing: Results of Recent Competitions* (GAO/NSIAD-99-44, Feb. 23, 1999). Also, a list of related products is included at the end of this report.

estimates were imprecise for a number of reasons. Baseline cost estimates from which savings were estimated were usually calculated using an average cost of salary and benefits for the number of authorized positions rather than using actual costs for the positions actually filled, which would have been more precise. While most baseline cost estimates were based largely on personnel costs, up to 15 percent of the costs associated with the government's most efficient organizations' plans or the contractors' offers were not personnel costs. Because these types of costs were not included in the baseline, a comparison of the baseline to the government's most efficient organization or contractor costs may have resulted in understating the cost savings. On the other hand, savings estimates did not reflect the study and implementation costs, which offset savings in the short term. Data limitations made it impractical to identify precise amounts of savings.

DOD has begun efforts to revise its information management systems to better track the estimated and actual costs of activities studied, though not to revise previous savings estimates. DOD is also emphasizing development of standardized baseline cost data for use in determining initial savings estimates. As a practical matter, however, many of the cost elements that are used in A-76 studies will continue to be estimated because DOD lacks a cost accounting system to provide actual costs. Further, reported savings from A-76 studies will continue to have some element of uncertainty and imprecision and will be difficult to track in the out years because workload requirements change, affecting program costs and the baseline from which savings are calculated. Given that the Department is reducing its operating budgets based on projected savings from A-76 studies, it is important that it have as much information as possible on savings being realized, including adjustments for up-front investment costs and other changes that may occur over time.

We made recommendations to the Secretary of Defense to use data obtained in tracking the implementation of A-76 study results to modify initial savings estimates and to study the potential to use a costing methodology to provide a better calculation of the baseline and other costs used to estimate savings. The Department generally agreed with the report and the recommendations.

Background

In 1966, the Office of Management and Budget (OMB) issued Circular A-76, which established policy for acquiring commercial activities. In 1979, OMB issued a supplemental handbook to the circular that included procedures for A-76 cost comparison studies to determine whether commercial

activities should be performed by the government, by another federal agency, or by the private sector. DOD currently refers to this program of A-76 cost comparison studies as competitive sourcing.

In conducting an A-76 cost study, an agency develops a performance work statement to identify the work to be done, prepares a government in-house cost estimate based on the "most efficient organization" that can accomplish the work, and compares this estimate with the lowest cost or best value offer selected from the private sector. The most efficient organization generally refers to a more streamlined, smaller version of the government organization than is currently doing the work. The government activity will be converted to performance by the private sector if the successful private sector offer is either lower by an amount equal to 10 percent of direct personnel costs of the most efficient organization or is \$10 million less over the length of the specified performance period than the in-house estimate. A more detailed description of the A-76 study process is contained in appendix III.

DOD records the results of its A-76 competitions in the Commercial Activities Management Information System. Each service and Defense agency maintains its own version of this management information system, but DOD requires each system to contain certain data elements for individual A-76 cost comparison studies, including numbers and length of individual studies, numbers of in-house military and civilian positions to be affected, comparisons of in-house and contractor-estimated costs, contract award dates, and changes in costs for 3 years after a contract award. We have previously reported some concerns about the accuracy and completeness of data contained in components' Commercial Activities Management Information Systems.⁴ Continuing concerns about the extent to which DOD was realizing savings from its A-76 studies prompted Congress, in the National Defense Authorization Act for Fiscal Year 1998,⁵ to require DOD to track cost information on the performance of commercial activities for up to 5 years during the term of a contract or an extension following implementation of the A-76 study results.

⁴*DOD Competitive Sourcing* (GAO/NSIAD-99-44, Feb. 23, 1999).

⁵Section 385, P.L. 105-85, amending 10 U.S.C. 2463.

Significant Savings Are Occurring, but Estimates Are Not Precise

DOD's savings from the nine A-76 studies we reviewed appeared significant, although available data indicated that savings were less than the \$290 million DOD initially projected. We found that savings occurred, regardless of whether governmental organizations or private contractors won the competitions. However, limitations in the way DOD components calculated savings made the original savings estimates imprecise. Further, costs for completing A-76 studies and implementing the results were not fully recognized in savings estimates, which logically would reduce estimated savings in the short run. After the study and implementation are completed, changes to operating requirements can occur that, in some cases, can affect the extent to which savings are realized and, in other cases, make tracking cost and savings estimates increasingly less practical over time.

Savings Resulting From A-76 Competitions

Available data indicated that DOD realized savings as a result of A-76 cost studies in at least seven of the nine cases, whether the in-house or private sector organization prevailed in the cost studies. Of the remaining two cases, data were insufficient for us to conclude whether savings were realized in one instance, and savings for the other one appeared to be negated by performance problems and contract termination after 20 months. Each of the cases examined presented circumstances that complicated our review of savings likely to be realized from these studies. In some cases, as discussed more fully in subsequent sections, we had to make assumptions concerning how closely estimated baseline costs approximated the actual costs. In other cases, we had to use the cost difference between the contractor's offer and the in-house most efficient organization's cost estimate as a starting point for estimated savings and later adjusted the savings to account for study and implementation costs and other factors. More complete observations on savings are included at the end of each case study in appendix I. Table 1 identifies the winner of the competitions and our assessment of the likelihood that savings occurred in each case.

Table 1: Competition Outcomes and Our Assessment of Whether Savings Were Achieved in Nine Case Studies

Case study	Winner of the competition	Savings likely, although less than original estimate	Savings uncertain	Savings unlikely
1. Missile maintenance activity, Redstone Arsenal, Alabama	In-house	X		
2. Storage and warehouse activity, Fort Riley, Kansas	Private sector			X
3. Child care center—Naval Medical Center, San Diego, California	Private sector	X		
4. Navy regional family services activity, San Diego, California	Private sector	X		
5. Aircraft maintenance, Altus Air Force Base, Oklahoma	In-house	X		
6. Base operating support, Laughlin Air Force Base, Texas	Private sector	X		
7. Air Force regional engine repair, Laughlin Air Force Base, Texas	Private sector		X	
8. Base operating support, Wright-Patterson Air Force Base, Ohio	Private sector	X		
9. Defense Finance and Accounting Service vendor payments, Columbus, Ohio	In-house	X		

Note: Although the private sector won two-thirds of the A-76 studies we analyzed, recent data indicated that the split between the public and private sectors was about even.

Source: Our analysis of DOD data.

For the three cases where the government's most efficient organization prevailed, savings were achieved because fewer persons were required to perform the work than before the studies were conducted. The clearest example of this was the Altus Air Force Base study involving aircraft maintenance. In initiating the study, the Air Force planned to convert its largely military workforce to civilian personnel, either government employees or employees of the private sector contractor, depending on the results of the A-76 study. Either way, civilian workers were expected to be less costly. We have previously reported that historical data suggest the potential for significant savings from such conversions because, on average, individual civilian positions are less costly than military positions.⁶ At Altus, the organization in place before the study had 1,444 authorized positions, 1,401 of which were military.⁷ After the study, the government's most efficient organization, which won, had 735 positions—all civilian. While this case suggests significant reductions in program costs and provides opportunities to reassign military personnel to other positions, the amount of budgetary savings likely in the future is unclear because the Air Force has recently indicated it does not expect to reduce military end strengths as a result of future A-76 cost studies. In the remaining two cases in which the government's most efficient organization prevailed, personnel reductions resulted in savings, however, other factors made determining the savings associated with these cases difficult.

In four of the six cases where contractors prevailed, savings were apparent and continued even after some contract modifications were made. In the other two cases, savings were not clear-cut.

⁶See *Base Operations: Challenges Confronting DOD as It Renews Emphasis on Outsourcing* (GAO/NSIAD-97-86, Mar. 11 1997), *DOD Force Mix Issues: Converting Some Support Officer Positions to Civilian Status Could Save Money* (GAO/NSIAD-97-15, Oct. 23, 1996), and *DOD Force Mix Issues: Greater Reliance on Civilians in Support Roles Could Provide Significant Benefits* (GAO/NSIAD-95-5, Oct. 19, 1994).

⁷As discussed later, in many of the case studies examined in this report, including Altus, the actual number of persons on board at the time of the cost comparison studies was often less than authorized, which inflated the projected level of savings.

Approaches Used to Calculate Savings Limited Precision of Estimates

Defense components used a variety of approaches in calculating savings estimates that limited the precision of their estimates. This occurred in part because, at the time the nine studies began, there was no official DOD guidance on calculating estimated costs of current operations for comparison with projected future costs, as a way of estimating savings.⁸ However, a calculation of estimated costs associated with the original in-house activity is important in determining the extent of budgetary savings resulting from the cost studies. Therefore, we sought to determine whether and how DOD components established baseline cost estimates as a basis for estimating savings from the cost comparison studies. For seven of the nine cases we reviewed, the Defense components estimated savings by subtracting the cost of the winning contractor's offer or most efficient organization's cost estimate from an estimated original cost of operations, which was largely derived from personnel costs. The approaches used in two of the seven cases also overstated the savings estimates because savings from other actions not related to the A-76 cost study were included. For example, in the Redstone Arsenal case study, Army officials incorporated in their A-76 savings estimated cost reductions resulting from workload reductions that were unrelated to the A-76 study. Also, the remaining two cases used different estimating methods.

In the seven cases where components used personnel reductions as a baseline for estimating savings, several factors limited the precision of the estimates. First, baseline costs were calculated using average salary and benefit costs, which could be greater or less than actual costs. Second, salary and benefit costs were computed on the number of authorized positions versus the number of positions actually filled at the time of the A-76 studies. Since the actual personnel levels were less than authorized in four cases, savings estimates based on a comparison with a baseline developed with authorized positions were overstated. (Actual personnel levels were more than authorized in two cases and, in one case, the number authorized and actual was not available.) Third, while most savings estimates were based largely on personnel costs, up to 15 percent of the costs associated with individual most efficient organization plans or contractor offers were not personnel-related in some cases. Because no amounts were included in the baseline cost original activity estimate for

⁸OMB Circular A-76, as revised, does not require organizations to calculate the cost of performing the original in-house activity to complete an A-76 study. The circular requires calculating the estimated cost for the government's proposed most efficient organization to fulfill requirements of the new performance work statement.

nonpersonnel-related costs, the calculated savings could be underestimated by the amount of those costs.

Finally, initial savings estimates for two of these seven cases were inflated by savings from other actions unrelated to determining whether the activity should be performed by the in-house organization or by a contractor. In the first instance, which involved the missile maintenance activity at Redstone Arsenal, changes were occurring concurrent with, but independent of, the study that would reduce the workload by 40 percent as well as decrease personnel requirements. Army officials included personnel reductions from both actions in their savings estimates from the study and, at the time of our review, they could not readily separate or estimate reductions related solely to the A-76 study. In the other instance, which involved the Defense Finance and Accounting Service's vendor payment activity at Columbus, Ohio, reengineering savings as a result of consolidating sites were captured as part of the A-76 study. However, according to a Defense Finance and Accounting Service official, the consolidation would likely have taken place regardless of whether an A-76 study was accomplished. Therefore, as with the Redstone case, officials combined personnel reductions and savings from these actions with those resulting from the A-76 study.

The remaining two cases at Fort Riley and San Diego used different approaches to calculate savings. At Fort Riley, the Army subtracted the costs associated with the winning contractor's offer from the costs associated with the in-house most efficient organization. On the surface, this approach would suggest savings were understated, since the most efficient organization would generally be expected to be more cost-effective than the existing organization. However, as noted earlier, performance problems resulted in the contract being terminated 20 months after award. In the second case, which involved the San Diego child care center, the Navy calculated savings on a per child basis by comparing the contractor's cost per child with the in-house cost per child. However, the extent of actual savings over previous operations was made uncertain by the fact that the winner of the cost study would be operating in a new facility that was expected to be more efficient than the previous operation. Also, the number of children actually served in the new facility was much greater than the number used to project savings. Long-term savings from this A-76 study became even more difficult to assess since, at the end of the 3-year contract period in September 1999, the activity was combined with other child care activities in the region and studied under a regional A-76 study. As a result of that A-76 study, the regionalized activity was returned in-house.

Unrecognized Costs Reduce Amount of Estimated Savings

Available data suggested that savings estimates were overstated because they did not include (1) all costs of conducting and implementing the results of the studies and (2) contract administration costs where applicable. In addition, some changes to the scope of work after A-76 study results were implemented which also reduced savings. Other changes that occur over time, unrelated to the original A-76 studies, can increasingly make it impractical to compare current costs of operation with those at the time of the A-76 studies.

Investment Costs Not Fully Considered in Developing Cost Estimates

The nine A-76 case studies we examined, like all such studies, incurred up-front investment costs that must be offset before net savings begin to accrue. They include costs of conducting the studies, personnel transition costs, and contract administration, as applicable. Costs for the first two are generally short term in nature, whereas, contract administration costs extend over the life of a contract, typically up to 5 years. However, components overstated savings estimates by not recognizing these costs in estimating their savings.

Based on officials' estimates of the costs to conduct the nine A-76 studies, we projected the cost per position studied ranged from an estimated \$364 for the Navy child care center, San Diego, California to an estimated almost \$9,000 for the Navy regional family services center, San Diego, California. In eight of the nine studies we reviewed, in-house personnel conducted the A-76 studies and the study costs represented installation officials' estimates of the salaries of in-house staff. The Defense Finance and Accounting Service vendor payment study was conducted with both in-house personnel and contractor support.⁹

Personnel costs associated with transition to either the government's most efficient organization or contractor performance of an activity were also not included in savings estimates. Agencies may incur personnel separation costs when reductions in force are required to implement the cost study results. These costs can include those associated with voluntary separation incentives or severance pay associated with involuntary reductions in force, and can sometimes be reduced by placing affected employees in vacant government positions. For the nine cases examined, personnel reduction cost estimates ranged from none at the Redstone Arsenal, where

⁹Available data indicated that all agencies are now using contractor personnel to help facilitate the completion of the studies.

personnel were placed in other comparable jobs, to a high of \$3 million at Wright-Patterson Air Force Base, where about 500 employees were affected by the decision to contract for the base operating support function. Further, for example, at the Altus Air Force Base aircraft maintenance activity, the Laughlin Air Force Base operating support activity, and the Wright-Patterson Air Force Base operating support activity, reduction-in-force procedures were used and affected personnel moved to lower graded positions. These employees retained the pay of their previous pay grades (known as "save pay"). Each of these costs served to reduce the savings expected in the short term and some, such as the save pay, had the potential to carry over into succeeding years.

When cost studies resulted in work being contracted with the private sector, the affected agencies also incurred costs to administer and oversee individual A-76 contracts. For the cases reviewed, the cost estimates ranged from an average of about \$12,000 per year for the San Diego child care contract to over \$635,000 per year for the Wright-Patterson Air Force Base operating support contract in fiscal year 1999. These costs were not factored into the cost savings estimates.

**Changes in Work Scope After the
A-76 Competition Is
Implemented Can Affect Savings**

Scope of work changes after A-76 study results have been implemented can reduce the extent to which the original estimates of savings are realized over the long term. In some cases, changes may include work that was incorrectly or inadvertently omitted from the statement of work used for the A-76 study. This type of change, which may increase operating costs, is logical to consider as reducing original savings estimates. In other cases, changes to work requirements, such as required by additional missions, could not have been anticipated at the time of the study and would have arisen regardless of who won the A-76 study. These changes may increase current operating costs but are unrelated to any calculation of savings. As the latter type occurs over time, it renders meaningless any attempt to compare costs of operation with those that existed before the A-76 study.

Among the six cases where work was awarded to contractors, two contracts had modifications to correct work statement omissions that, according to government officials, should have been included in the original statement of work. One modification to the Wright-Patterson Air Force Base statement added about \$92,000, or less than 1 percent, to the total contract and the other to the Fort Riley statement added \$187,000, or 6 percent. Changes in the scope of work or mission after the studies were completed increased the work statement for one most efficient organization at Altus Air Force Base by \$3.4 million, or 2 percent, and one

for the base operating support contractor at Laughlin Air Force Base by \$830,000, or 3 percent. In three other cases, contracts were subsequently modified to reflect increases in Department of Labor wage rates—\$116,000, \$334,000, and \$440,000, or about 1 percent of the total cost of each contract.

**Savings, However
Imprecise, Remained
Following Adjustments for
Unrecognized Costs**

Once weaknesses in the components' savings estimates were taken into account and adjustments were made for unrecognized costs, available data indicated that savings remained in most instances. At the same time, each of the cases examined presented unique circumstances that complicated our review of savings likely to be realized from these studies. Neither we nor DOD could precisely quantify the extent of savings from these nine cases.

In some instances, we had to make assumptions concerning how closely estimated baseline costs approximated the actual costs. In other instances, we had to use the difference between a contractor's offer and an in-house most efficient organization cost estimate as a starting point for estimated savings and make subsequent adjustments to account for study and implementation costs and other factors. However, to the extent we could account for these cost factors, it appeared that savings, however imprecise, were realized in seven of the cases (as shown in table 1).

**Improvements Still
Required in DOD's
Efforts to Track Costs
and Savings From
Competitive Sourcing**

DOD officials are in the process of improving the Commercial Activities Management Information Systems to address previously identified weaknesses, as well as developing mechanisms intended to better track costs in response to legislative requirements.¹⁰ However, DOD does not have plans for updating projected savings data initially recorded in components' Commercial Activities Management Information Systems. Having precise savings estimates is important because of the Department's efforts to reduce operating budgets in anticipation of savings.

¹⁰10 U.S.C. 2463.

**Improved Guidance to
Standardize Cost
Comparison Data**

The Office of the Secretary of Defense (OSD) is working to update its overall commercial activities program guidance dated September 1985. Department officials told us that they expect to issue the guidance later this year. DOD issued procedural guidance in September 1999 to standardize the database used for capturing the results of A-76 cost comparison studies. The guidance emphasized that the original cost of an activity should be determined by the estimated total cost (expressed in work years) before the development of the government's most efficient organization. Guidance issued on April 3, 2000, expanded the guidelines to state that estimates of annual work years should be determined by the number of actual civilian work years required to perform the work being studied during the 12 months prior to the cost comparison study. According to an OSD official, savings estimates will be based on the difference between this baseline estimate of personnel costs and the costs associated with either the winning contractor's offer or the government's most efficient organization cost estimate over the life of the contract or specified term.

**Improvements in Tracking
Costs Planned**

An official responsible for the DOD's A-76 program told us that they expect to issue additional guidance that focuses on tracking operating costs after A-76 cost studies are completed and the results are implemented. They project that mechanisms for tracking this cost information will be in place by July 2000. The official also told us that under the new guidance, when changes cause costs to change, the reason for the changes will be reflected in the components' Commercial Activities Management Information Systems. The involved installation will maintain supporting documentation for the changes. However, even when a change affects the initial savings estimate, the Department currently does not plan to adjust the estimates recorded in its Commercial Activities Management Information System. However, absent adjusting the savings estimates in this system or elsewhere, the Department lacks an effective basis for systematically assessing the extent to which projected savings are being realized. Since the Department is reducing future operating budgets in anticipation of savings, we believe having more accurate savings estimates to review during the annual budget process would be useful in reassessing whether or not the initial savings projections were accurate.

Despite the planned information system improvements, many of the database cost elements will continue to be estimated because, as we have previously reported, DOD lacks reliable financial and cost data to establish actual baseline costs and determine the effectiveness of its reforms.¹¹ In 1995, the Federal Accounting Standards Advisory Board¹² developed a set of managerial cost accounting standards that require federal agencies to provide reliable and timely information on the full cost of federal programs, their activities, and outputs, and to report costs continuously, routinely, and consistently.¹³ The standards did not require the use of a particular type of costing system or methodology. While acknowledging that several costing methodologies have been successful in the private sector and in some government entities, federal entities were encouraged to evaluate the potential of activity-based costing as an effective managerial tool. Activity-based costing focuses on the activities of a production cycle and uses cost drivers (such as length of time an activity is performed) to assign costs through activities to outputs. In 1999, we reported that Defense components had begun to develop some activity-based costing models, primarily to promote better business practices.¹⁴ We found little effort, however, had been devoted to building costing models for the purpose of providing a more accurate indication of baseline costs, which should provide better savings estimates for A-76 cost studies. Further, no other costing methodology is being promoted for use in A-76 studies, an OSD official said.

¹¹DOD has been attempting to improve its financial data for many years and in October 1998 issued to Congress a Biennial Financial Management Improvement Plan. The plan provided a first-ever vision of DOD's future financial management environment and identified an array of improvement initiatives. See *Financial Management: Analysis of DOD's First Biennial Financial Management Improvement Plan* (GAO/AIMD-99-44, Jan. 29, 1999) for our assessment of the plan. Also see *Department of Defense: Progress in Financial Management Reform* (GAO/T-AIMD/NSIAD-00-163, May 9, 2000).

¹²The Federal Accounting Standards Advisory Board was created in October 1990 by the Secretary of the Treasury, the Director of OMB, and the Comptroller General to consider and recommend accounting principles for the federal government.

¹³Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Standards* (July 31, 1995).

¹⁴*DOD Competitive Sourcing: Lessons Learned System Could Enhance A-76 Study Process* (GAO/NSIAD-99-152, July 21, 1999).

Conclusions

Most of the A-76 cases we examined showed that DOD attained savings although weaknesses in baseline cost data and the omission of implementation costs meant the savings were not as great as initially projected. Data limitations, such as imprecise baseline costs, and mitigating factors that affected individual cases made it impractical for us to attempt to determine revised savings estimates that would be considered precise. The Department likewise will be unable to develop more reliable estimates of savings from its A-76 studies until it improves its initial cost estimates and includes study and implementation costs, and other factors that may reduce expected savings over time. Until DOD implements a financial management system capable of producing accurate and reliable cost data, the use of a costing methodology, such as activity-based costing, as an interim measure may help to provide more accurate baseline and other costs and provide better savings estimates for A-76 studies. Improved estimates are important because of the Department's practice of reducing operating budgets that are based on expected savings. The guidance recently provided or planned, if fully implemented, can be an important step in the right direction toward addressing this problem. However, we believe additional actions are needed to ensure that changes in costs and savings are tracked on an ongoing basis and that efforts are made to systematically track changes in savings estimates and to use the data to periodically reassess planned reductions in operating budgets based on projected savings.

Recommendations

To improve the precision of savings estimates resulting from A-76 studies, we recommend that the Secretary of Defense (1) develop an appropriate mechanism for assessing changes in A-76 savings in a systematic manner and require components to use data obtained in tracking the implementation of A-76 study results to update initial savings and projected savings estimates during the annual budget process and (2) study the potential to use a costing methodology as an interim measure to provide a better estimation of baseline and other costs used to estimate savings from A-76 studies.

Agency Comments and Our Evaluation

The Deputy Under Secretary of Defense (Installations) provided written comments on a draft of this report. The Department generally agreed with the report and its recommendations. The Department also provided some technical comments, which were incorporated in the report as appropriate. The Department's comments are included in appendix IV.

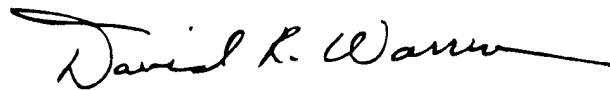
The Department agreed with our recommendation in our draft report that Defense components use data obtained in tracking the implementation of A-76 study results to modify initial savings estimates in their Commercial Activities Management Information Systems, although it emphasized that these information systems capture actual costs, not savings. It plans, however, to improve savings estimates based on the actual data captured in these systems for use during the budget process. While the Department's response in our discussions with Defense officials suggested that these systems may not provide the optimum mechanism to track changes in savings, we believe it is important to have some mechanism to capture savings on an ongoing basis. Scope of work changes, necessitated due to omissions, after A-76 study results have been implemented can reduce the extent to which original estimates of savings are realized over the long term. We modified our recommendation to emphasize the importance of generating reliable savings data to use in the budget decision process.

The Department also agreed with our recommendation to study the potential to use a costing methodology as an interim measure to provide better baseline and other cost data to estimate savings from A-76 studies. According to the Department, the services have efforts underway to develop activity-based cost accounting systems it believes will improve management oversight.

We are sending copies of this report to Representative Solomon Ortiz, Ranking Minority Member, Subcommittee on Military Readiness, House Committee on Armed Services; and Senator James M. Inhofe, Chairman, and Senator Charles Robb, Ranking Minority Member, Subcommittee on Readiness and Management Support, Senate Committee on Armed Services. We are also sending copies of this report to the Honorable William S. Cohen, Secretary of Defense; the Honorable Louis Caldera, Secretary of the Army; the Honorable Richard Danzig, Secretary of the Navy; the Honorable F.W. Peters, Secretary of the Air Force; General James L. Jones, Commandant of the Marine Corps; and the Honorable Jacob J. Lew,

Director, Office of Management and Budget. Copies will be made available to others upon request. GAO contacts and other key contributors are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink, reading "David R. Warren". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

David R. Warren, Director
Defense Management Issues

Summary Information for Nine A-76 Case Studies

The following provides key information surrounding the nine A-76 case studies included in this report. In general, the results of the A-76 studies indicated there are savings. In all but one of the nine cases, the winner of the competition was determined by selecting the lowest cost option between the selected private sector offer and the government's most efficient organization. In the one case, the higher cost government's most efficient organization won the competition because the private sector's offer was not either lower by an amount equal to 10 percent of direct personnel costs of the most efficient organization or at least \$10 million less over the length of the performance period than the in-house estimate. In all cases, the most efficient organization contained fewer personnel than the previous in-house organization. This would suggest that regardless of the winner, cost studies resulted in a more streamlined, cost-efficient operation and savings may be assumed. However, in one case, while the lowest cost option was selected, serious performance problems ensued, and the contract was terminated.

In an effort to make a more precise determination of savings, we focused on determining whether and how baseline costs were established as a basis for projecting savings in the Department of Defense (DOD) components' Commercial Activities Management Information Systems. When baseline data were not established, we focused on the differences between costs projected for in-house most efficient organizations and contractor proposals. We also examined what costs were associated with conducting the studies and implementing the results, what changes that may have occurred following implementation of the results that could affect costs and savings, and collectively what these data indicated about the level of projected savings. In selected instances, we identified unanticipated factors that adversely affected the ability to determine savings.

Missile Maintenance Activity—Redstone Arsenal, Alabama

Overview: The Army performs maintenance operations on various missile systems and related equipment at its Redstone Arsenal. In fiscal year 1998, after an A-76 cost study in which the in-house organization prevailed, the Army converted its missile maintenance activity to the government most efficient organization. According to the Army's Commercial Activities Management Information System, estimated savings were \$2 million per year, representing a 65-percent savings over the original cost of operations, for a total of about \$6 million over a 3-year period.¹ Of the costs identified in the government's most efficient organization estimate, about 89 percent were personnel-related and an Army installation official stated that about 90 percent of the costs identified in the competing contractor's offer were personnel-related.

Basis for Initial Savings Projection: In completing this A-76 study, Army officials did not calculate a baseline cost for their existing maintenance activity. Army officials predicated their savings on the elimination of all 13 military positions and 21 of the 39 civilian positions actually performing this activity—a 65-percent reduction in the 52 authorized positions. Savings were calculated using an average cost per position. However, as noted later, some unspecified portion of the reduction was tied to workload reductions unrelated to the A-76 study.

Study and Implementation Costs: Redstone Arsenal officials estimated that they incurred in-house staff costs of almost \$63,000 in fiscal year 1998 to conduct the A-76 study. No contractor support was used to conduct the study. Officials identified no civilian transition assistance costs because all affected personnel were placed in other positions at the arsenal.

Changes in Work Requirements Following Implementation of Study Results: We identified no significant changes to work requirements after completion of the cost study that might have affected the level of savings initially projected.

¹This figure differs from the \$100,000 in estimated multiyear savings we reported in an earlier report. An Army headquarters official said the estimates differ because installation officials originally calculated savings based on an average salary of \$50,000 per position. Army headquarters revised the estimated savings figure in its management information system to reflect fringe benefits in the average salary used in the most efficient organization estimate. The later reflects a more accurate estimate, the official said.

Other Mitigating Factors: At about the same time that Redstone Arsenal officials were studying their missile maintenance activity, the Army was removing missile systems from its inventory so the systems no longer needed maintenance support. This change was expected to reduce the activity's workload hours by about 40 percent. Accordingly, a reduction in personnel was planned before the A-76 study began and reductions began during the study.

The revised workload provided the basis for developing the government's most efficient organization estimate and contractor proposals and ensured a common basis for comparison. However, in calculating the savings resulting from the A-76 study, Army officials included personnel reductions associated with both the workload reduction and the study because DOD did not require that calculations be adjusted to reflect A-76 savings only. Officials said they could not separate out or estimate reductions related solely to the A-76 study.

Although the government's most efficient organization estimate of almost \$3.2 million exceeded the contractor's nearly \$3 million offer, the most efficient organization was selected because, as provided in Office of Management and Budget (OMB) Circular A-76 guidelines, the contractor's offer was not lower by an amount equal to 10 percent of the direct personnel costs of the most efficient organization or at least \$10 million less over the length of the performance period than the in-house estimate.

Summary Observations Regarding A-76 Savings: Available data indicated savings were achieved, but the precise amount could not be determined since baseline operating costs were not established and many of the personnel reductions were not related to the A-76 study. Redstone Arsenal officials said their accounting systems did not provide the level of detail necessary to determine activity costs, including the cost to maintain various missile systems before or after conversion to the most efficient organization. Therefore, we could not determine actual costs, and we had to use an estimated cost to adjust the government's projected net savings to reflect the effect of up-front A-76 study costs. However, assuming an approximate correlation between the percentage change in workload (missiles to be maintained) of 40 percent and the 65 percent in personnel reductions, a majority of the projected savings could have resulted from the study. Thus, study and implementation costs of about \$63,000 appeared to play a limited role in reducing the remaining projected savings.

Army Storage and Warehousing Activity—Fort Riley, Kansas

Overview: In fiscal year 1996, after completing an A-76 study, Fort Riley awarded a firm fixed price contract for its storage and warehousing activity. The Army's commercial activities database showed \$1.2 million in annual savings were estimated, representing a 66-percent savings over the most efficient organization estimate, for a total of almost \$6 million over a 5-year period.² The contract was terminated after 20 months because of performance problems. Costs identified in the government's most efficient organization were 98 percent personnel-related and, according to a Fort Riley official, costs identified in the contractor's offer were 98 to 100 percent personnel-related.

Basis for Initial Savings Projection: Army officials estimated savings based on the difference between the cost projected for its most efficient organization and the competing contractor's proposal. Assuming the same level of work as previously performed, using this method could result in understating the expected savings because an A-76 study usually results in performing the work with less personnel.

Study and Implementation Costs: Costs associated with the A-76 study and its implementation totaled \$524,000. Fort Riley officials estimated it cost \$147,000 to conduct the A-76 study in fiscal years 1995 and 1996 using in-house personnel. The study resulted in eliminating all 29 government positions, including some temporary workers. While the study was ongoing, most of the employees found other jobs; only eight permanent employees remained by the time the study was completed. During a reduction in force held to implement the results of this study, four of the eight employees were placed in comparable government jobs and four were placed in lower graded positions, although they retained their previous pay levels under "save pay" provisions. Fort Riley officials, however, could not provide the specific costs associated with the reduction in force of these eight employees because this action was included in a basewide reduction in force unrelated to the A-76 study. Officials also estimated contract administration costs were \$126,000 and \$251,000 in fiscal years 1996 and 1997, respectively.

²As discussed, the savings figure in the Army's Commercial Activities Management Information System database is higher from what we reported previously. The Army's revised estimated savings figure is based on the average salary and fringe benefits in the most efficient organization estimate and, according to an Army headquarters official, the \$1.2 million figure is more accurate.

Changes to Work Requirements Following Implementation of Study

Results: During the 20-month contract period, modifications to the contract were made that increased the contract costs by about \$453,000 for that period. Contract payments substantially exceeded the offer price by about \$238,000 during the 8 months the contract was in effect in fiscal year 1996 and by \$215,000 in fiscal year 1997. Roughly three-quarters of the 1996 cost increase was due to a requirement added to the work statement that added \$187,000 (or 6 percent) to the total cost of the contract. The remaining contract cost increases for both fiscal years 1996 and 1997 were due to the addition of work because of a change in mission and to resolve workload backlogs and disputes.

Other Mitigating Factors: Contracting officials stated that there were numerous performance problems with contractor operations since the beginning of the contract. Officials stated that the contractor significantly underbid the requirement and that there was no way to quantify the cost of the lack of service and support provided the customer. This contract was terminated at the conclusion of fiscal year 1997, and the contractor was paid about \$828,000 to settle disputed costs.

Summary Observations Regarding A-76 Savings: Given the difficulties that occurred under this contract and the early termination, we did not attempt to calculate any savings for the period the contract was in effect, given that savings were likely not achieved.

Navy Child Care Center—Naval Medical Center, San Diego, California

Overview: In fiscal year 1997, as the result of its simplified A-76 cost study,³ the Navy contracted for its child care activity at the Naval Medical Center in San Diego using a firm fixed price contract. The contract price was on a per child basis tied to age and the number of children actually enrolled. The Navy estimated that it would realize savings of about \$3,400 per child annually, a savings of 55 percent from costs per child in the government's most efficient organization developed for the cost study (which was the same cost per child of the previous activity). Installation officials projected savings of about \$1 million over a 3-year period based on serving an average of 100 children over that time period.⁴ Officials estimated the costs identified in the most efficient organization and the original organization were 100-percent personnel-related. The competing contractor's offer did not identify what percentage was personnel-related costs because it was based on a per child fixed price.

Basis for Initial Savings Projection: In determining the expected level of savings, Navy officials used a baseline cost of existing operations as the basis for the proposed most efficient organization, even though the most efficient organization was using a low capacity, obsolete, and more costly facility than the new facility the winning organization would occupy. They projected savings of about 55 percent based on the difference between the cost of service per child included in the government's most efficient organization (\$6,200) estimate and the winning contractor's proposal (\$2,800) multiplied against an expected caseload of 100 children in the new facility. The cost comparison was based on serving 79 children; however, the initial savings estimate was projected for an average of 100 children per year.

Study and Implementation Costs: Navy officials estimated study costs of \$12,000 using in-house personnel. The study resulted in eliminating 33 government positions; however, all personnel, except one, obtained

³OMB Circular A-76 Revised Supplemental Handbook provides simplified cost comparison procedures that may be used for activities involving 65 full-time equivalent positions or less.

⁴The Navy's Commercial Activities Management Information System reports a smaller 3-year savings figure (\$700,000). According to a Navy headquarters official, the estimate provided by installation officials was more accurate. Once data are entered into the Navy's system, the headquarters official said, entries such as estimated savings are not changed or revised. Further, the installation officials' figure was more reliable because the installation has current information and, since this contract is no longer in effect, reconstructing the basis for the savings figure in the system would be difficult, the official said.

comparable positions in the area. That one individual, according to Navy officials, was separated subject to the reduction in force at a cost of \$2,600. The officials reported costs of \$11,000 to administer the contract in fiscal year 1997. In the following 2 years, the government incurred costs of about \$12,000 each year for contract administration.

Changes in Work Requirements Following Implementation of Study

Results: Government costs for the contract increased from initial estimates because more children (about 170 per year) were enrolled each year of the contract than the number used to calculate estimates (100). The increased population served would also suggest a higher cost avoidance between the contractor's proposal and the government's most efficient organization estimate. Costs to run the child care center were based on a combination of costs per child (variable based on the child's age) and a parent co-payment. The contract called for the contractor to subtract the co-payment from the fixed rate for the child and bill the government for the remaining amount. The average cost per child actually averaged about \$3,400 based on varying age groups and parent co-payments.

Other Mitigating Factors: An original baseline cost per child was used, even though the government had built a new, larger child care facility to replace the original center, which was obsolete. The Navy estimate did not make any adjustments to estimate the cost efficiencies to be gained from occupying a modern and higher capacity facility. Not adjusting for possible efficiencies may have overstated the government's estimated cost per child and thus the savings per child compared with the contractor's cost per child. Both the in-house organization's estimate and the contractor's price were based on serving 79 children in the new facility. Navy officials based their initial savings estimate on an enrollment of 100 children. However, as noted, the number of children actually enrolled was greater than anticipated, averaging about 170 over the 3-year contract. The Navy may have understated the total savings because it underestimated the children to be served.

By the end of the 3-year contract in September 1999, however, the activity had been combined with other child care activities in the region, studied under another A-76 cost comparison, and implemented under a regional government most efficient organization. Therefore, no additional savings or cost avoidance was attributable to this single study after September 1999. Any subsequent savings would be reported as part of the new A-76 regional child care study.

Summary Observations Regarding A-76 Savings: Determining a precise level of savings was not possible because of the factors that clouded the savings calculation. Since baseline operations changed, it was not possible to determine how savings would have been affected if adjustments would have been made during the A-76 study for cost efficiencies based on the new, higher capacity facility and a more accurate count of children served. Nevertheless, available data indicated contractor operations were significantly less costly than the proposed in-house operation and, the difference was not significantly reduced by the cost of conducting and implementing the study. A subsequent A-76 study of providing child care services on a regional basis identified the potential for additional savings and returned the function in-house.

Navy Regional Family Services Activity—San Diego, California

Overview: In fiscal year 1998, the Navy consolidated its family services activity at three locations in San Diego, California, and contracted for it using a firm fixed price plus award fee contract. The family service activity provides personal support services, such as marital and financial counseling. Installation officials said that about \$1.8 million in annual savings were estimated, or savings of 35 percent over existing operations (based on authorized positions), for a total of \$9 million over a 5-year contract period.⁵ Officials estimated that, historically, about 84 percent of in-house costs were personnel-related. During fiscal years 1998 and 1999, roughly 96 percent of contract costs were personnel-related.

Basis for Initial Savings Projection: Navy officials calculated the projected savings by comparing an estimate of baseline costs for fiscal year 1996 with the contractor's offer. The estimated baseline costs were calculated by multiplying the number of authorized positions for the existing activity by the salary and fringe benefit costs projected on the average mid-point in each affected grade. Using this approach, officials identified a baseline cost of about \$5 million for the 79 civilian and 10 military positions, representing authorized positions at the three consolidated activities. However, according to a Navy official, the actual number of personnel performing the activity totaled 117, plus about 40 volunteers. Navy officials pointed out that the additional personnel were

⁵The Navy's Commercial Activities Management Information System includes a higher estimated savings figure (\$10.3 million). However, a Navy headquarters official said the \$9 million revised figure provided by installation officials was more reliable because the installation has access to current information.

predominately military that were temporarily placed at the center awaiting a change in duty or a release from service and there was no specific requirement that military personnel operate the center. The difference between the authorized positions and the actual suggested the baseline costs were understated. At the same time, another perspective on savings is found in the difference between the total costs associated with the most efficient organization used in the cost study and the winning contractor's price, which was about \$3 million less over a 5-year contract period.

Study and Implementation Costs: Costs to conduct the A-76 study using in-house personnel were estimated at about \$800,000 and \$51,000 in costs associated with implementing a reduction in force at one of the three locations. We could not determine if similar costs were incurred at the other two locations because a Navy official said data from the locations were not tracked and could not be reconstructed. Navy officials said contract administration cost about \$148,000 annually.

Changes in Work Requirements Following Implementation of Study Results: We identified no changes in statement of work nor any mandated wage increases during the period covered by our review.

Other Mitigating Factors: Navy officials estimated that during the 8 months of fiscal year 1998 that the contract was in place and for all of fiscal year 1999, contract payments were 83 and 95 percent of projected costs, respectively. The decrease occurred because the contractor did not earn all award fees. Award fee criteria included the results of customer satisfaction surveys.

Summary Observations Regarding A-76 Savings: This cost study appears to have produced sizeable savings over previous operating costs, yet the precise amount of those savings remains unclear given limitations in baseline costs and uncertainties over the number of personnel previously required to perform the work. Additionally, the government's most efficient organization indicated about 14 percent of its costs were nonpersonnel-related. Precisely how much this will affect the initial projection of about \$1.8 million in annual savings is unclear. However, data suggested a majority of the savings would remain, or increase, if those costs were fully accounted for. The savings would then be reduced by about \$1.6 million in study, implementation, and contract administration costs, but those reductions represent less than a year's projected savings.

Air Force Aircraft Maintenance—Altus Air Force Base, Oklahoma

Overview: In fiscal year 1996, following an A-76 study, Altus Air Force Base converted its aircraft maintenance activity performed predominately by military personnel to a government most efficient organization performed by civilian personnel only. According to the Air Force's Commercial Activities Management Information System, annual savings of almost \$100 million over a 5-year period were estimated: a savings of 38 percent over existing operations. This case represents the largest estimated savings amount of the nine A-76 studies reviewed. Of the costs identified in the most efficient organization, about 97 percent were personnel-related. An Air Force official estimated that about 92 percent of the competing contractor's offer consisted of personnel-related costs.

Basis for Initial Savings Projection: The Air Force developed its savings projection by taking the difference between its estimated 5-year baseline cost for the existing operation of \$265 million and the in-house most efficient organization of \$166 million. The baseline cost was developed using an estimated cost of 1,401 authorized military and 43 authorized civilian positions. The actual number of total personnel assigned was 1,248 (1,206 military and 42 civilians), according to Air Force officials, or 14 percent less than the 1,444 authorized. The most efficient organization was based on an estimated average cost for 735 authorized civilian positions, about 97 percent of the total cost reflected personnel costs. Air Force officials said they could not determine whether non-personnel costs were included in the original operating cost figure.

Study and Implementation Costs: Air Force officials reported that they incurred estimated costs of about \$948,000 to perform the study and about \$2.2 million of that was related to civilian personnel reductions for "save pay" through the end of fiscal year 1999. Estimated costs for save pay for fiscal years 1996 to 2001 were about \$3.7 million or almost \$706,000 per year. We can expect that some of these costs can continue for some time unless the affected employees leave government service or are promoted to their previous pay grades.

Changes in Work Requirements Following Implementation of Study Results: Costs for the period we reviewed increased by about \$3.4 million after implementation of the most efficient organization due to a change in mission. The mission change was unanticipated and was not an omission from the original performance work statement.

Other Mitigating Factors: The government's most efficient organization was scheduled to be fully implemented by December 1996; however, hiring problems delayed implementation until April 1998. During conversion to the government most efficient organization, Altus Air Force Base officials experienced problems recruiting fully qualified aircraft mechanics. Lower wage scales at Altus Air Force Base compared to bases located in areas with higher wage scales caused retention problems. In addition, during the time Altus Air Force Base officials were trying to hire qualified personnel, the Air Force centralized its hiring office at Randolph Air Force Base, further slowing the hiring process. Also during this time, some aircraft were maintained at other installations, military personnel were brought to or retained at Altus Air Force Base to maintain aircraft, and the Air Force began an intensive aircraft mechanic training program. As a result, Air Force officials told us they encountered unanticipated transition costs of about \$2.4 million. By April 1998, according to officials, the most efficient organization was fully operational and accomplishing its mission. According to available data, the activity spent, in total, about \$5 million less than budgeted amounts during the last 3 months of fiscal year 1996 and fiscal years 1997 to 1999.

Summary Observations Regarding A-76 Savings: The initial savings estimate was overstated because it was based on the cost of authorized personnel (includes salary and fringe benefits), whereas the actual number of personnel on board was about 14 percent less. Also, officials said they did not have documentation that other nonpersonnel costs were not accounted for. Even so, the magnitude of savings likely to be realized from going from an organization of 1,248 military and civilian positions to 793 authorized civilian positions (a revised authorization figure reflecting the workload increases) still represents a sizeable savings, even after accounting for study and implementation costs.

Air Force Base Operating Support— Laughlin Air Force Base, Texas

Overview: In fiscal year 1997, Laughlin Air Force Base contracted for its base operating support activity on a firm fixed price basis. Base operating support encompasses the civil engineering, supply, and transportation functions. According to the Air Force's Commercial Activities Management Information System, almost \$6 million in annual savings were estimated, a savings of about 50 percent over existing operations, for a total of almost \$30 million over a 5-year contract period. According to a Laughlin official, about 92 percent of the winning contractor's offer represented personnel-related costs. Available data indicated estimated costs under the most efficient organization were nearly all personnel-related.

Basis for Initial Savings Projection: The Air Force developed its savings projection by taking the difference between its estimated baseline costs for the existing operation compared with the contract price. The baseline costs were developed by calculating an average cost of 278 authorized positions (including salary and fringe benefits). The actual number of personnel assigned as of the date the A-76 study was completed was 121. (The number of actual personnel assigned as of the date the A-76 study was announced was unavailable.)

Study and Implementation Costs: In fiscal year 1997, the Air Force incurred about \$1.2 million in A-76 study costs, about \$1.2 million for transition costs, and almost \$203,000 in save pay costs. Save pay costs of almost \$195,000 and \$198,000 were also incurred in fiscal years 1998 and 1999, and some unspecified portion of the save pay costs could continue into subsequent years of the contract unless the affected workers leave government service or again attain their previous pay grades. Additionally, the Air Force identified annual recurring costs for contract administration—more than \$320,000 for fiscal year 1997, \$323,000 for fiscal year 1998, and \$378,000 for fiscal year 1999.

Changes in Work Requirements Following Implementation of Study Results: We identified no changes in work requirements that should have been known at the time the performance work statement was developed for the A-76 study. However, contract payments increased by about \$830,000—about \$207,000 in fiscal year 1997, \$583,000 in fiscal year 1998, and \$40,000 in fiscal year 1999—due to increased workload.

Other Mitigating Factors: Contract costs increased by \$334,000, or \$71,000 in fiscal year 1998 and \$263,000 in fiscal year 1999, reflecting Department of Labor mandated wage increases. Actual contract payments were 4 percent, 11 percent, and 3 percent greater than original estimates for fiscal years 1997, 1998, and 1999, respectively, because of the mandated wage increases and workload changes.

Summary Observations Regarding A-76 Savings: Available data indicated savings were realized from this A-76 study, but less than initially projected. If one assumes identified costs provide a rough approximation of previous costs, the contractor's proposal represents a significant savings over prior operations. However, there were some limitations in the accuracy of the estimated baseline costs from which savings projections were developed because personnel costs were developed on an average

basis. Also, the \$6 million in projected annual savings would have to be offset by study and implementation costs.

Regional Engine Repair—Laughlin Air Force Base, Texas

Overview: In fiscal year 1997, Laughlin Air Force Base contracted for its engine regional repair center under a fixed price with award fee contract. The center repairs aircraft engines that used to be repaired in-house and under contracts at Randolph, Sheppard, Vance, and Laughlin Air Force Bases. According to the Air Force's Commercial Activities Management Information System, savings of \$25.5 million over a 51-month period were estimated, a savings of about 45 percent over its existing operations. The contractor's offer was 92-percent personnel-related costs, and the government's most efficient organization estimate was 89-percent personnel-related costs.

Basis for Initial Savings Projection: The Air Force projected \$25.5 million in savings by taking the difference between \$56.9 million, the estimated original cost of operations, and \$31.4 million, the contractor price. The savings calculation was based on consolidating and competing workload at six Air Force Bases—Randolph, Sheppard, Vance, Laughlin, Columbus, and Reese—however, workload at just four bases was, in fact, consolidated. The Air Force did not have data readily available breaking out projected savings for these four bases.

Study and Implementation Costs: The Air Force estimated almost \$1.4 million in A-76 study, implementation, and contract administration costs for fiscal years 1997 to 1999. Specifically, Air Force officials reported estimated costs of (1) \$377,000 to conduct the A-76 study and (2) \$159,000 in fiscal year 1997 to pay for personnel retained during the transition from the in-house activity to the contractor. They also reported \$70,000 for separation incentive pay in fiscal year 1997. Officials said they incurred a total of \$81,000 for save pay between fiscal year 1997 and 1999 due to reduction-in-force actions. While the amounts declined each year, some amount of save pay costs are likely to continue for unspecified subsequent years. The officials reported contract administration costs of about \$72,000 in fiscal year 1997, \$282,000 in fiscal year 1998, and \$340,000 in fiscal year 1999.

Changes in Work Requirements Following Implementation of Study Results: We identified no changes in work requirements that should have been known at the time the performance work statement was developed for the A-76 study.

Other Mitigating Factors: According to Air Force officials, savings estimates were based on an original cost of operations reflecting authorizations at one location only, although the activity was also being performed at the other locations by contractor personnel. Officials said the cost of contract personnel was included in the estimates, but yet they could not provide documentation supporting the calculation. Additionally, the Air Force originally planned to consolidate the engine repair function at six bases into one. However, it never consolidated the engine work at one base because it closed. Engine work from a second base was also not consolidated because of transition problems and the Air Force decided to retain a separate repair contract at the second base. Yet, the savings projection in the commercial activities database reflected the expected savings from consolidating workload at all six bases.

Actual contract payments exceeded estimates by about 11 percent in fiscal year 1997, 25 percent in fiscal year 1998, and 17 percent in fiscal year 1999, largely because the contractor had to hire additional personnel to address work backlogs. Backlogs occurred because the contractor was unable to hire skilled personnel quickly due to the installation's remote location. Further, personnel that worked in the activity when it was in-house transferred to other installation activities when the activity converted to contract and, as a result, were unavailable to work for the contractor. The contractor hired workers from the original in-house activity on a temporary basis to meet repair requirements. Actual costs also exceeded estimates due to mandated wage increases. There was one contract cost increase in 1998 of almost \$116,000 to pay for Department of Labor mandated wage increases.

Summary of Observations Regarding A-76 Savings: We could not determine whether savings were achieved from this cost comparison because the baseline data were inaccurate, overstating the savings estimate. The baseline consisted of the costs of performing the function at six bases, but two of the six bases were never consolidated into Laughlin.

Air Force Base Operating Support— Wright-Patterson Air Force Base, Ohio

Overview: At the end of fiscal year 1998, Wright-Patterson Air Force Base contracted for its base operating support activity under a firm fixed price plus award fee contract. Wright-Patterson's base operating support multifunction activity includes base supply, transportation, maintenance, a laboratory, and a laboratory supply function. According to the Air Force's Commercial Activities Management Information System, \$14 million in annual savings was estimated, for a total of almost \$58 million over

49-month contract period, or a savings of about 59 percent over its previously existing operating costs. About 86 percent of the costs identified in the government's most efficient organization estimate were for personnel. Officials could not estimate the contractor's personnel percentage because the offer did not break down the contractor's costs.

Basis for Initial Savings Projection: The Air Force developed its savings projection by taking the difference between its estimated baseline costs for the existing operation and the contract price. The baseline costs included personnel costs for the 499 authorized positions based on an estimated average cost per position, including salary and fringe benefits. The actual number of personnel assigned when the study was announced was 503—the additional 4 positions being filled by military personnel temporarily assigned to the organization.

Study, Implementation, and Contract Administration Costs: Study, personnel reduction, and contract administration costs totaled about \$6 million. Of this amount, according to officials, about \$2.2 million was to conduct the A-76 study. During fiscal years 1998 and 1999, the officials indicated they had incurred a total personnel reduction cost of about \$3 million (about \$691,000 for reduction-in-force actions, \$641,000 for priority placement, \$1.3 million for separation incentive payments, \$10,000 for career transition assistance, and \$381,000 for save pay associated with reduction-in-force actions). Contract administration costs were \$163,539 and \$635,399 for fiscal years 1998 and 1999.

Changes in the Contract Following Implementation of Study

Results: We identified one small change to the performance work statement to add a task previously omitted; however, the amount was about \$92,000 or less than one percent of total contract costs.

Other Mitigating Factors: Actual contract payments exceeded estimates for fiscal year 1998 by \$1.3 million because the cost of the 2-month transition period was not included in the cost comparison estimates for either the contractor or the most efficient organization. The cost was excluded because Air Force officials said they believed it would be about the same for the contractor and the most efficient organization. During our review, a contract change occurred due to a Department of Labor mandated wage increase of about \$440,000, which increased costs by about 1 percent.

Summary Observations Regarding A-76 Savings: This cost study appears to have produced sizeable savings over previous operating costs, yet the precise amount of those savings remains unclear given limitations in baseline costs—these costs were estimated based on average personnel costs. The government's most efficient organization indicated about 14 percent of its costs were not personnel-related. Precisely how much this would affect the initial projection of about \$14 million in annual savings is unclear, but the data suggest a majority of the savings would remain if those costs were fully accounted for. The savings would then be reduced by about \$6 million in study, implementation, and contract administration costs, but those reductions represent less than a year's projected savings.

Defense Finance and Accounting Service Vendor Payments— Columbus, Ohio

Overview: In 1998, after completing an A-76 study, the Defense Finance and Accounting Service retained its vendor payment activity in-house but implemented the most efficient organization used in the cost comparison study. The activity processes payments to Defense Commissary Agency vendors. The agency estimated it would realize \$10 million in annual savings, for a total of \$50 million in savings over 5 years. This total suggested an estimated savings of 79 percent over previous operations. For the costs identified in the most efficient organization estimate, about 87 percent were personnel-related, whereas about 69 percent of the costs associated with the contractor's offer were personnel-related.

Basis for Initial Savings Projection: The Defense Finance and Accounting Service developed its savings projection based on a reduction from 240 to 75 authorized positions. However, only 206 personnel were actually assigned at the beginning of the A-76 study, about 14 percent less than the authorized level. The 165 authorized positions eliminated were multiplied by a \$61,000 average cost of salary and fringe benefits to arrive at the \$10 million annual savings.

Study and Implementation Costs: Agency officials indicated that they incurred costs of \$828,000 to complete their A-76 study, including in-house personnel and contracted support. They identified implementation costs in fiscal year 1998 of about \$419,000, which included separation incentives, retaining staff to assist in the conversion, and the priority placement program. Additional costs of almost \$16,000 were incurred in fiscal year 1999 for remaining priority placement program costs. About \$117,000 of the fiscal year 1998 implementation cost was for implementing reduction-in-force actions. Officials said they could not provide separate

costs for administration and oversight of the most efficient organization because these costs are considered overhead.

Changes in Work Requirements Following Implementation of Study

Results: There were no cost increases associated with changes to the performance work statement. However, changes to the grade structure and a reassessment of tasks allowed the activity to reduce nine positions in 1999, saving an estimated \$452,000 between 1999 and 2002, or about \$158,000 per year.

Other Mitigating Factors: As part of the A-76 study, Defense Finance and Accounting Service officials decided to consolidate the workload from three locations into one, and savings from this effort were included in the A-76 savings calculation. This action, however, was unrelated to determining whether the activity should be performed by the in-house organization or by a contractor. According to a Defense Finance and Accounting Service official, the consolidation would likely have taken place regardless of whether an A-76 study was accomplished. Also, as mentioned before, not all of the 240 authorized positions were filled. Thus, the A-76 estimated savings were overstated. Columbus Center officials estimated that the savings from the A-76 study would have been about \$25 million or about \$5 million annually, if the savings from the consolidation action were not included. However, according to a senior Defense Finance and Accounting Service official, the consolidation decision was made as part of the A-76 study and, therefore, the agency's projected savings estimate will remain at \$50 million.

Actual operating costs of \$2.5 million roughly equaled estimated costs for fiscal year 1999. Actual operating costs for fiscal year 1998 were \$2.3 million, just under the \$2.6 million estimated cost for the year.

Summary Observations Regarding A-76 Savings: According to available data, savings realized from this A-76 study were much less than initially projected by the Agency because savings from unrelated management efforts were combined with results of the A-76 study. Also, data indicated that a certain amount of previously existing operating costs were not identified since the savings calculation was based only on personnel costs (the most efficient organization data indicated that about 13 percent of the costs were nonpersonnel-related.) In addition, actual personnel on board was 14 percent lower than the authorized level used to calculate the savings, which would further tend to overstate savings. However, available data indicate that savings would remain, even after

Appendix I
Summary Information for Nine A-76 Case
Studies

accounting for short-term offsets to account for study and implementation costs.

Objectives, Scope, and Methodology

Based on a request from the Chairman of the Subcommittee on Military Readiness, House Committee on Armed Services, we conducted this review to assess the extent of savings being realized from completed A-76 studies. We followed a case study approach, examining the results of 9 of the 53 A-76 studies completed between October 1995 through March 1998, where projected savings from the 9 represented over half of projected savings from the 53 studies (\$290 million out of a total of \$528 million.) We selected this time frame with the expectation that documentation of costs and any changes to workload or mission would be more readily available and that sufficient time would have elapsed since implementation of the study results to permit examination of savings. We judgmentally selected cost comparison studies to provide a mix of activities converted to a government most efficient organization and those converted to a contractor. We also included studies that were done by the Army, the Navy, the Air Force (the Marine Corps had not completed any studies) and the Defense Finance and Accounting Service. The sample we reviewed was insufficient to identify trends and was not projectable to the universe of A-76 studies. However, the sample gives some indication of the challenges DOD faces in characterizing savings from A-76 studies. See table 2 for the A-76 studies we reviewed.

Table 2: A-76 Cost Comparison Studies Reviewed

Service/Defense agency	Location	Function	Positions studied (authorized)	Winner
Army	Redstone Arsenal, Ala.	Missile maintenance	52	Government organization
	Fort Riley, Kans.	Storage and warehouse	29	Contractor
Navy	San Diego, Calif.	Child care center	33	Contractor
	San Diego, Calif.	Family service centers	88	Contractor
Air Force	Altus Air Force Base, Okla.	Aircraft maintenance	1,444	Government organization
	Laughlin Air Force Base, Tex.	Base operating support	278	Contractor
	Laughlin Air Force Base, Tex.	Regional jet engine maintenance	50	Contractor
	Wright-Patterson Air Force Base, Ohio	Base operating support	499	Contractor
Defense Finance and Accounting Service	Columbus, Ohio	Defense Commissary Agency vendor payment	240	Government organization

To determine whether the DOD's A-76 studies had achieved savings, we assessed the validity of DOD's savings projections for individual studies and compared actual costs with projections for each of the nine A-76 studies selected. We interviewed installation-level officials and reviewed supporting documentation to determine whether and what original baseline cost estimates had been established or how savings were otherwise estimated. Since most A-76 studies result in personnel reductions, we also sought to determine the number of personnel authorized and actually on-board when the cost studies began. We also sought to obtain and compare available information concerning costs associated with the government's most efficient organization estimate used in the cost comparisons as well as costs associated with the private sector proposals. Likewise, we also obtained information concerning costs associated with conducting the studies, as well as civilian personnel transition and contract administration and oversight costs.

In general, officials were able to provide supporting documentation for most of the cost information we requested. However, a significant portion of the figures were reconstructed estimates based on available documentation and cognizant officials' assumptions, such as the cost of the original in-house organization and the conduct of the A-76 study. In some cases, we estimated costs based on documentation provided by DOD officials. Further, in a few instances, cost figures were based on an official's best guess because documentation could not be found. We did not independently verify the data provided.

To identify DOD's efforts to improve processes for tracking changes to costs and savings estimates, we interviewed officials from the Office of the Secretary of Defense; the Departments of the Army, the Navy, and the Air Force; and the Defense Finance and Accounting Service. We also reviewed OSD and service guidance on the competitive sourcing program.

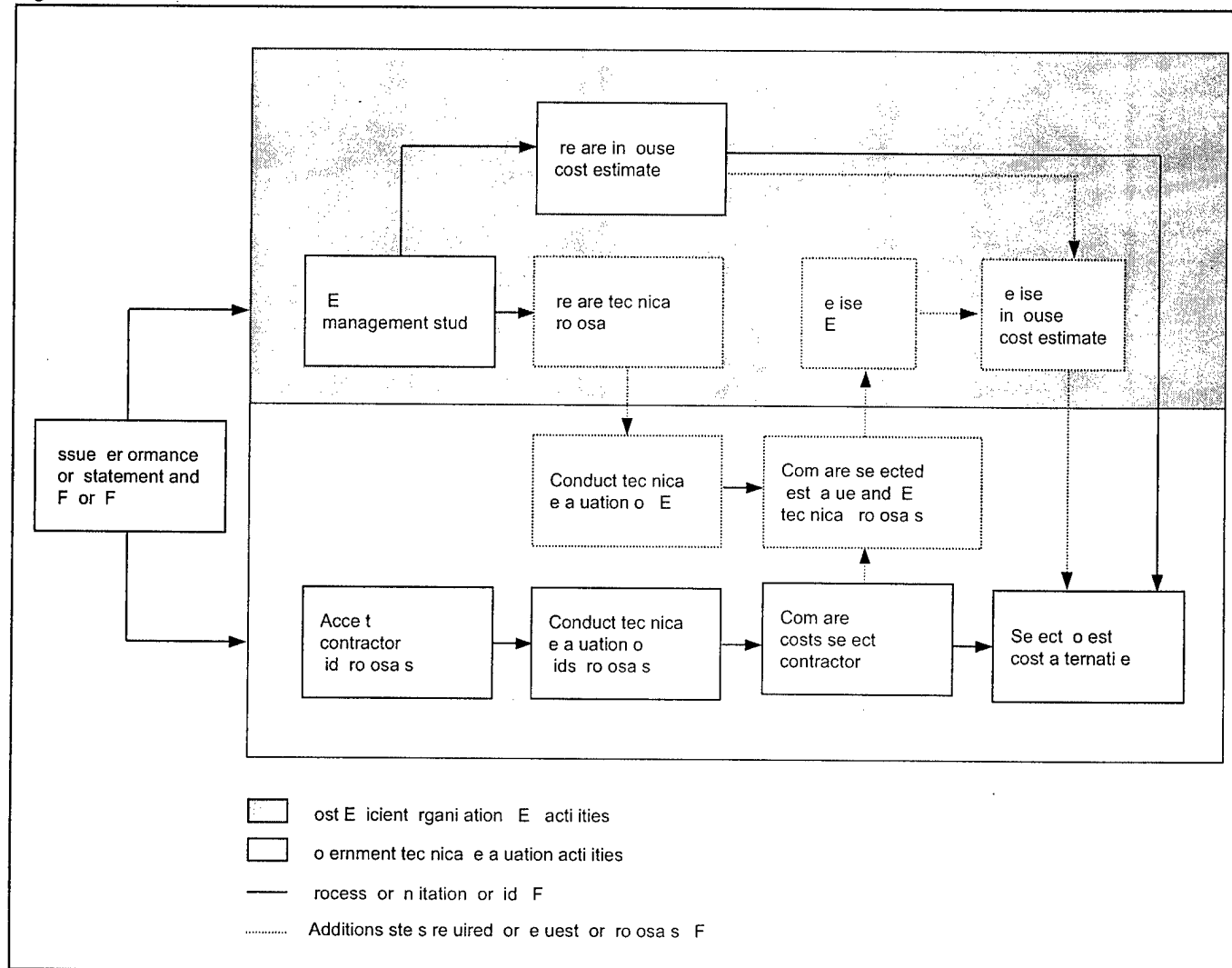
We conducted our review from July 1999 through May 2000 in accordance with generally accepted government auditing standards.

A-76 Study Process

In general, the A-76 process consists of six key activities—(1) developing a performance work statement and quality assurance surveillance plan; (2) conducting a management study to determine the government's most efficient organization; (3) developing an in-house government cost estimate for the most efficient organization; (4) issuing a Request for Proposals or Invitation for Bids; (5) evaluating the proposals or bids and comparing the in-house estimate with a private sector offer or interservice support agreement and selecting the winner of the cost comparison; and (6) addressing any appeals submitted under the administrative appeals process, which is designed to ensure that all costs are fair, accurate, and calculated in the manner prescribed by the A-76 handbook.

Figure 1 shows an overview of the process. The solid lines indicate the process used when the government issues an Invitation for Bids or Request for Proposals requesting bids or proposals on the cost of performing a commercial activity. This type of process is normally used for more routine commercial activities, such as grass-cutting or cafeteria operations, where the work process and requirements are well defined. The dotted lines indicate the additional steps that take place when the government wants to pursue a negotiated, "best value" procurement. This type of process is often used when the commercial activity involves high levels of complexity, expertise, and risk.

Figure 1: Overview of the A-76 Process



Source: Air Force Air Education and Training Command documents.

The Circular A-76 requires the government to develop a performance work statement. This statement, which is incorporated into either the Invitation for Bids or Request for Proposals, serves as the basis for both government estimates and private sector offers. If the Invitation for Bids process is used, each private bid company develops and submits a bid, giving its price for performing the commercial activity. While this process is taking

place, the government activity performs a management study to determine the most efficient and effective way of performing the activity with in-house staff. Based on this "most efficient organization," the government develops a cost estimate and submits it to the selecting authority. The selecting authority concurrently opens the government's estimate along with the bids of all private sector firms.

If the Request for Proposals—best value process—is used, the Federal Acquisition Regulation and the A-76 supplemental handbook require several additional steps. The private sector offerors submit proposals that often include a technical performance proposal and a price. The government prepares an in-house management plan and a cost estimate based strictly on the performance work statement. On the other hand, private sector proposals can offer a higher level of performance or service.

The government's selection authority reviews the private sector proposals to determine which one represents the best overall value to the government based on such considerations as (1) performance levels, (2) proposal risk, (3) past performance, and (4) price. After the completion of this analysis, the selection authority prepares a written justification supporting its decision. This includes the basis for selecting a contractor other than the one that offered the lowest price to the government. Next, the authority evaluates the government's most efficient organization and determines whether it can achieve the same level of performance and quality as the selected private sector proposal. If not, the government must then make changes to its most efficient organization to meet the performance standards accepted by the authority. This is intended to ensure that the in-house cost estimate is based upon the same scope of work and performance levels as the best value private sector offer. After the authority determines that the most efficient organization and the private sector proposal are based on the same level of performance, the cost estimates are compared.

According to Office of Management and Budget's A-76 guidance, the activity will be converted to performance by the private sector if the private sector offer is either lower by an amount equal to 10 percent of the direct personnel costs of the in-house estimate or is \$10 million less over the performance period than the in-house estimate, whichever is less. The Office of Management and Budget established this minimum cost differential to ensure that the government would not convert performance for marginal estimated savings.

Participants in the process—for either the Invitation for Bids or Request for Proposals process—may appeal the selection authority's decision if they believe the costs submitted by one or more of the participants were not fair, accurate, or were not calculated in the manner prescribed by the A-76 handbook. Appeals must be submitted in writing and within 20 days after the date that all supporting documentation is made publicly available. The appeal period may be extended to 30 days if the cost comparison is particularly complex. Appeals are supposed to be adjudicated within 30 days after they are received.

Comments From the Department of Defense



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

July 28, 2000

Mr. David R. Warren
Director, Defense Management Issues
National Security and International Affairs Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Warren:

This is the Department of Defense (DoD) response to the GAO draft report, "DOD COMPETITIVE SOURCING: Savings Are Occurring, But Actions Are Needed to Improve Accuracy of Savings Estimates," May 26, 2000 (GAO Code 709452/OSD Case 2020). This draft report is a case study of nine completed A-76 cost comparisons which were selected from those reviewed in another GAO Report on: DOD Competitive Sourcing: Results of Recent Competitions (GAO/NSIAD-99-44, Feb. 23, 1999). We concur with both recommendations, but with specific clarification on the first.

The first GAO recommendation states: "In order to improve the precision of savings estimates resulting from A-76 competitions, we recommend that the Secretary of Defense require components to use data obtained in tracking the implementation of A-76 study results to modify initial savings estimates in their commercial activities management information systems, where applicable . . ." Actual costs (vice savings) are reported in CAMIS at the end of each performance period and are analyzed to update savings estimates. As noted in the report, we have continued to improve our savings estimates based on actual execution data, specifically with respect to including study costs. We will continue to refine these estimates to improve the accuracy of future budget submissions.

The second GAO recommendation states: "In order to improve the precision of savings estimates resulting from A-76 competitions, we recommend that the Secretary of Defense . . . study the potential to use a costing methodology as an interim measure to provide better estimation of baseline and other costs used to estimate savings from A-76 studies." We concur with this recommendation. The Department's interim guidance for the Strategic and Competitive Sourcing Programs issued on April 3, 2000 defined how Components are to capture baseline annual workyears for cost comparisons. This guidance is consistent with the finding in the GAO report, i.e., personnel costs represent 85% of the costs in a cost comparison. We believe this baseline provides a reasonable, albeit conservative, savings estimate for use in building DoD competitive sourcing programs. We recognize that we must continue to make improvements in how baseline costs are calculated in order to reflect the true costs of operating our functions regardless of whether they are competed via the Competitive Sourcing Program or not. OSD directed "the Secretaries of the Military Departments and the Directors of the Defense Agencies to pursue aggressively ABC/M [activity based costing and management] implementation in maintenance depots and everywhere else it could be expected to provide



Appendix IV
Comments From the Department of Defense

improved cost management." The Military Departments are all in varying stages of implementing this guidance. Particularly encouraging is the use of ABC principles by the Navy and Marine Corps to establish baseline costs for their strategic sourcing programs. Nonetheless, it is expected to take several years to implement these procedures.

The extent to which the Department will allow the Army, Air Force and Defense Agencies to use Strategic Sourcing to help meet the study goals previously associated with the A-76 program is uncertain. Several key factors that will affect the extent of approval include: the reliability of savings projections; the level of detail provided as to which functional areas would be reviewed and the specific changes proposed in such area; the schedule for implementation; the availability of funding to implement the proposed changes; and the presence of an ongoing program for future years.

I appreciate the opportunity to comment on the draft report. Should you have any specific questions regarding my response to your recommendations, please contact my point of contact for this report, Mrs. Annie Andrews, at (703) 602-2608.

Sincerely,



Randall A. Yim
Deputy Assistant Secretary
(Installations)

GAO Contacts and Staff Acknowledgments

GAO Contacts

Barry Holman (202) 512-5581
Marilyn Wasleski (202) 512-8436

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In addition to those named above, Christine Frye, Thad Rytel, and Jonathan Silverman made key contributions to this report.

Related GAO Products

Competitive Contracting: The Understandability of FAIR Act Inventories Was Limited (GAO/GGD-00-68, Apr. 14, 2000).

DOD Competitive Sourcing: Potential Impact on Emergency Response Operations at Chemical Storage Facilities Is Minimal (GAO/NSIAD-00-88, Mar. 28, 2000).

DOD Competitive Sourcing: Plan Needed to Mitigate Risks in Army Logistics Modernization Program (GAO/NSIAD-00-19, Oct. 04, 1999).

DOD Competitive Sourcing: Air Force Reserve Command A-76 Competitions (GAO/NSIAD-99-235R, Sept. 13, 1999).

DOD Competitive Sourcing: Lessons Learned System Could Enhance A-76 Study Process (GAO/NSIAD-99-152, July 21, 1999).

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OMB Circular A-76: Legislation Has Curbed Many Cost Studies in Military Services (GAO/GGD-91-100, July 30, 1991).

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